

**IT 99-9**

**Tax Type: Income Tax**

**Issue: Responsible Corporate Officer – Failure to File or Pay Tax**

**STATE OF ILLINOIS  
DEPARTMENT OF REVENUE  
OFFICE OF ADMINISTRATIVE HEARINGS  
SPRINGFIELD, ILLINOIS**

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**THE DEPARTMENT OF REVENUE  
OF THE STATE OF ILLINOIS**

**v.**

**“J. J. JINGLEHEIMER SMITH”, as  
Responsible Officer of “ABC Corp.”,  
and “XYZ, Ltd.”,**

**Taxpayer**

**No. 98-IT-0000  
SS # 000-00-0000  
NOD # 0001 and 0002**

**Kenneth J. Galvin  
Administrative Law Judge**

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**RECOMMENDATION FOR DISPOSITION**

**Appearances:** Mr. Lance Jones, appearing on behalf of “J. J. Jingleheimer Smith”, Mr. Jim Day appearing on behalf of the Department of Revenue of the State of Illinois.

**Synopsis:**

This matter comes on for hearing pursuant to the protest of “J. J. Jingleheimer Smith” (hereinafter “Smith”) to Notices of Deficiency (“NOD”) Nos. 0001 and 0002 issued by the Department of Revenue against him on September 3, 1997, as a responsible officer of “ABC Corp.” (hereinafter “ABC”) and “XYZ, Ltd.” (hereinafter “XYZ”), respectively. The NOD’s represent a penalty liability for withholding taxes for the third and fourth quarter of 1995. A hearing was held on this matter on April 5, 1999, with “Smith” providing testimony. Following submission of all

evidence and a review of the record, it is recommended that NOD No. 0001 be cancelled and NOD No. 0002 be affirmed for the third quarter of 1995 and the month of October, 1995. In support thereof, the following “Findings of Fact” and “Conclusions of Law” are made.

**Findings of Fact:**

1. The Department’s *prima facie* case, inclusive of all jurisdictional elements, is established by the admission into evidence of NOD Nos. 0001 and 0002, both dated September 3, 1997, reflecting a total liability due and owing for unpaid withholding tax for the third and fourth quarter of 1995, issued to “Smith”, as responsible officer of “ABC Corp.” and “XYZ Ltd.”, in the amounts of \$1,305.73 and \$3,778.70, respectively. Dept. Ex. Nos. 1, 2, 3.
2. “ABC” was a not-for-profit organization formed to help individuals with drug addiction. “Smith” was assistant secretary of “ABC”. Tr. p. 6.
3. On March 6, 1995, “Smith” submitted a letter of resignation to the Board Members of “ABC”, effective as of February, 1995. Tr. p. 7; Taxpayer’s Ex. No. 19.
4. “XYZ” was an organization formed to help individuals with drug and alcohol abuse, and counseling. “Smith” invested \$25,000 in “XYZ”, was a shareholder, and a member of the Board of Directors. Tr. p. 8.
5. “John Doe” was corporate executive officer of “XYZ”, and was responsible for “XYZ’s” financial affairs. “Doe”, “Richard Roe”, “Harold Hill”, and “Joe Doakes” were also shareholders and directors of “XYZ”. Tr. pp. 11-12.
6. On October 17, 1995, the Board issued notice of an emergency meeting. The notice stated that the Board had voted in a quorum to request that “Doe” turn over all corporate documents in his possession within 48 hours of the meeting, including records and

- receipts for 1995 and unwritten and cancelled checks. The Board had become aware of personal conduct on “Doe’s” part that was not compatible with operating a rehabilitation institute. Tr. pp. 13-14, 28-29; Taxpayer’s Ex. No. 1.
7. On October 23, 1995, the Board adopted a resolution that all corporate accounts of “XYZ” on deposit at the First National Bank of Illinois be changed to allow only “Richard Roe” and “J.J “Smith”” to have signatory authority and the authority to bind “XYZ” on the renewal or extension of promissory notes with the Bank. Tr. pp. 15-16, 29-30; Taxpayer’s Ex. No. 2; Dept. Ex. No. 7.
  8. “Smith” signature authority on the account was effective from October 24, 1995, through November 30, 1995. During the period when “Smith” was a signatory, he did not pay any tax liabilities on behalf of “XYZ”. Tr. pp. 16, 31-32, 34; Taxpayer’s Ex. No. 3.
  9. On October 31, 1995, The “Doe” Law Firm, P.C., representing “John Doe”, sent a letter to the First National Bank advising that the resolutions adopted by “XYZ” on October 23, 1995, were “null and invalid as they were adopted in violation of the Articles of Incorporation and Bylaws...”. “Smith” received a copy of this letter. Tr. pp. 17, 32; Taxpayer’s Ex. No. 4.
  10. On November 1, 1995, The “Doe” Law Firm, P.C. sent a letter to “Harold Hill” advising that the firm intended to meet with the State’s Attorney for “Largeville” County concerning the embezzlement of corporate funds and the handling of social security checks payable to “XYZ”. “Smith” received a copy of this letter. Tr. p. 18; Taxpayer’s Ex. No. 6.

11. On November 1, 1995, “John Doe” sent notice of a special meeting of the shareholders of “XYZ” to be held November 13, 1995, for the purpose of removing “Hill”, “Roe” and “Doakes” from the Board. “Smith” received a copy of this notice. Tr. pp. 18-19; Taxpayer’s Ex. Nos. 7, 8.
12. On November 3, 1995, “Joe Doakes” wrote to shareholders, directors and officers of “XYZ” regarding alleged illegal activity surrounding the costs of care provided by “XYZ” and reimbursements from the state and federal government. “Smith” received a copy of this letter. Tr. pp. 20-21; Dept. Ex. No. 8.
13. On November 10, 1995, “Peter Piper”, attorney for “J.J Smith” and “Joe Doakes”, wrote to The “Doe” Law Firm, stating that “XYZ” had multiple claims against “Harold Hill”, “Richard Roe”, and “John Doe” for malfeasance and misadministration of corporate affairs and demanded their resignations as corporate directors, officers and employees. Tr. p. 23; Taxpayer’s Ex. No. 10.
14. On December 8, 1995, “Smith” resigned as director of “XYZ”, citing, *inter alia*, corporate improprieties, and the directors’ refusal to investigate and discuss the matters. Tr. pp. 23-25; Taxpayer’s Ex. No. 17.
15. On January 6, 1998, “Harold Hill” pleaded guilty to filing false claims and mail fraud. On February 4, 1997, “Richard Roe” pleaded guilty to “theft of monies of the United States” related to his work at “XYZ”. On June 5, 1998, “John Doe” was indicted for conspiracy to defraud the United States, filing false claims and mail fraud related to his work at “XYZ”. Tr. pp. 38-39; Taxpayer’s Ex. Nos. 14, 15, 16.

### **Conclusions of Law:**

The Department seeks to impose personal liability on “Smith” pursuant to Section 1002(d) of the Illinois Income Tax Act for the failure to pay withholding taxes. 35 ILCS 5/1002(d). The personal liability penalty is imposed by Section 3-7 of the Uniform Penalty and Interest Act, which provides as follows:

Any officer or employee of any taxpayer subject to the provisions of a tax Act administered by the Department who has the control, supervision or responsibility of filing returns and making payment of the amount of any trust tax imposed in accordance with that Act and who willfully fails to file the return or to make the payment to the Department or willfully attempts in any other manner to evade or defeat the tax shall be personally liable for a penalty equal to the total amount of tax unpaid by the taxpayer including interest and penalties thereon. The Department shall determine a penalty due under this Section according to its best judgment and information, and that determination shall be *prima facie* correct and shall be *prima facie* evidence of a penalty due under this Section.  
35 ILCS 735/3-3.

It is clear under the statute that personal liability will be imposed only upon a person who: (1) is responsible for filing corporate tax returns and/or making the tax payments; and (2) “willfully” fails to file returns or make payments.

The admission into evidence of the NOD’s establishes the Department’s *prima facie* case with regard to both the fact that “Smith” was a “responsible” officer and the fact that “Smith” “willfully” failed to file and/or pay. Branson v. Department of Revenue, 168 Ill. 2d 247, 262 (1995). Once the Department has established a *prima facie* case, the burden shifts to the taxpayer to overcome the presumption of liability through sufficient evidence that the person was either not a responsible officer or employee, or that his actions were not willful. *Id.*

I have concluded, based on the testimony and evidence admitted at the evidentiary hearing, that “Smith” was not a responsible party of “ABC”. “Smith” testified that he was assistant secretary of “ABC”. Tr. p. 6. On March 6, 1995, “Smith” submitted a letter of resignation “(T)o Board Members,” effective as of February, 1995. Tr. p. 7; Taxpayer’s Ex. No. 19. When the letter of resignation was admitted into evidence, counsel for the Department stipulated “to the authenticity and admissibility of this exhibit.” Tr. p. 7. Based on this stipulation, I must presume that the date that the letter was sent and the effective date of the resignation are authentic. These dates would preclude “Smith” from being a responsible party during the third and fourth quarter of 1995, the time period at issue in the NOD. Accordingly, based on the limited testimony presented, I have concluded that “Smith” was not a responsible party of “ABC”, during the time period covered by the NOD.

There is a question as to what “Smith” role was in “XYZ”. “Smith” was a shareholder in “XYZ” and was on the Board of Directors. Tr. pp. 8-9. “Smith” testified that he was neither an employee nor an officer of “XYZ”. Tr. p. 9. “Smith” testified that he did not make decisions regarding what creditors were paid and he did not supervise or “sign off on” tax statements to be filed with the Department. Tr. p. 9. Additionally, “Smith” testified that “John Doe” was “CEO” of “XYZ” and that the other corporate officers were “Richard Roe” and “Harold Hill”. Tr. pp. 11-12. “Joe Doakes” was “assistant secretary.” Tr. p. 12. These three individuals were shareholders, directors and employees of “XYZ”. Tr. p. 12. “Smith” also testified that he was a “full time electrician” and full time pastor at “Resurrection Center Church” during 1995. Tr. p. 26.

“Smith” testimony emphasizes his noninvolvement in “XYZ” during the time period in question, but the testimony must be balanced against the fact that he had signature authority on the checking account at the First National Bank of Illinois. “Smith” and “Richard Roe” were given this

signature authority, by corporate resolution, at a meeting of the Board held on October 23, 1995. Tr. pp. 15-16, 29-30; Taxpayer's Ex. No. 2; Dept. Ex. No. 7. The signature authority was effective from October 24, 1995, through November 30, 1995. Tr. pp. 16, 31-32, 34; Taxpayer's Ex. No. 3. "Smith" and "Roe" were also given the authority to bind "XYZ" on the renewal or extension of promissory notes with the Bank. Tr. pp. 15-16, 29-30.

"Smith" testified that the Bank "froze" the corporate account in response to the letter written by The "Doe" Law Firm to the Bank on October 31, 1995. Tr. pp. 17, 32. This letter advised the Bank that the resolutions adopted by "XYZ" which changed the signatories on the checking account were "null and invalid" as they were adopted in violation of "XYZ"'s Articles and Bylaws. Taxpayer's Ex. No. 4. The October 31, 1995, letter states that the Bank will "be held accountable" for any action taken by the Bank pursuant to the resolution. The letter does not demand or request that the Bank "freeze" the account. "Smith" was asked on cross-examination how he became aware that the account was frozen. Tr. p. 32. He responded that he had a relationship with Mr. "Fitzer", an employee of the Bank and the addressee of the October 31, 1995, letter, and that Mr. "Fitzer" had made him aware that the account was frozen. "Smith" did not remember if the Bank had provided him with any type of written documentation that would indicate that the Bank was freezing "XYZ's" account. Tr. p. 32.

"Smith" testimony is that his signature authority was in effect for a seven-day period, from October 24, 1995, the date that the corporate resolution became effective, through October 31, 1995, the date the Bank received the letter from The "Doe" Law Firm. However, the copies of the Bank signature card contain the notation "REPLACED BY NEW CARDS," November 30, 1995. Taxpayer's Ex. No. 3. Additionally, "Smith" did not have any written documentation from the Bank showing that the account had been "frozen." Tr. p. 32. "Smith" did not present a statement of

the account showing what, if any, checks were negotiated during the period at issue. Evidence must be presented which is consistent, probable and identified with the corporation's book and records. Central Furniture Mart Inc. v. Johnson, 157 Ill.App.3d 907 (1<sup>st</sup> Dist. 1987). Without some written documentation, I am unable to conclude that "Smith" did not write checks on the account or that his signature authority ended on October 31, 1995.

In determining whether an individual is a responsible person, the courts have indicated that the focus should be on whether that person has significant control over the business affairs of a corporation and whether he or she participates in decisions regarding the payment of creditors and disbursement of funds. Monday v. United States, 421 F.2d 1210 (7<sup>th</sup> Cir. 1970), *cert. denied*, 400 U.S. 821 (1970). Liability attaches to those with the power and responsibility within the corporate structure for seeing that taxes are remitted to the government. *Id.* I must conclude, based on the testimony and evidence presented, that "Smith" had the authority to write checks on the corporate checking account from October 24, 1995, through November 30, 1995, a period included in the NOD. Accordingly, "Smith" was able to participate in decisions regarding the payment of creditors and the disbursement of funds and could have written a check for taxes. The evidence indicates that "Smith" had the authority and responsibility to direct that taxes be paid and accordingly, he is a responsible party under the statute.

The second element which must be met in order to impose personal liability is the willful failure to pay the taxes due. The Department presents a *prima facie* case for willfulness with the introduction of the NPL into evidence. Branson v. Dept of Revenue, 168 Ill.2d 247 (1995). The burden, then, is on the responsible party to rebut the presumption of willfulness.

35 ILCS 735/3-7 fails to define what constitutes a willful failure to pay taxes. The Illinois Supreme Court accepts as indicia of willfulness, a showing of "reckless disregard for obvious or



known risks” as set forth in cases dealing with section 6672 of the Internal Revenue Code. Department of Revenue v. Heartland Investments, 106 Ill. 2d 19, 29 (1985). In the case of Wright v. United States, 809 F2d 425, 427 (7<sup>th</sup> Cir. 1987), the Seventh Circuit Court of Appeals held that a “responsible person” is liable if he (1) clearly ought to have known that (2) there was a grave risk that withholding taxes were not being paid and if (3) he was in a position to find out for certain very easily. Willfulness also includes a “failure to investigate or to correct mismanagement after having notice that withholding taxes have not been remitted to the government.” Peterson V. United States, 785 F. Supp. 1209, 1217 (N.D. Ill. 1990).

“Smith” attempted to rebut the presumption of willfulness by testifying that he was unable to get the corporate records from “Doe”. “Smith” testified that he was not given tax records or documents. Tr. p. 25. “If I had the records I would have just made it known to the board of directors, but I didn’t. I didn’t have any way of getting that information.” Tr. p. 33. No evidence was presented that “XYZ” closed down during the time period at issue, and I must conclude, therefore, that “XYZ” continued to operate. With “XYZ” continuing to operate, “Smith” clearly ought to have known that employees were being paid and that withholding taxes were continuing to accrue. Since “Smith” was aware of the “power struggle” at “XYZ”, he should have known that there was a risk that withholding taxes were not being paid to the Department of Revenue.

Although “Smith” testified that he would have paid the taxes had he been given the corporate records, this testimony is disingenuous. “Smith” was in a position to find out for certain if the taxes were being paid by simply calling the Department of Revenue or by checking with the First National Bank of Illinois to see if checks payable to the Department of Revenue had been negotiated. “Smith” failure to investigate whether taxes were being remitted constitutes

“willfulness,” and accordingly, I have concluded that “Smith” willfully failed to pay “XYZ’s” withholding taxes.

“Smith” resigned from “XYZ” on December 8, 1995. Tr. pp. 23-25; Taxpayer’s Ex. No. 17. NOD No. 3117, issued for the withholding tax liability of “XYZ”, includes the amount of \$1878.81 for the third quarter of 1995 and \$1898.89 for the fourth quarter of 1995. All payments for the third quarter of 1995 were due by the date of “Smith” resignation. The payment for October withholding taxes was due by November 15, 1995, prior to “Smith” resignation. All other payments for the fourth quarter of 1995 were due after “Smith” resignation, and accordingly, “Smith” is not liable for these amounts. 35 ILCS 5/704(c)

WHEREFORE, for the reasons stated above, it is my recommendation that Notice of Deficiency Nos. 0001 be cancelled and Notice of Deficiency No. 0002 be affirmed for the third quarter of 1995 and the month of October, 1995.

ENTER:

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Kenneth J. Galvin  
Administrative Law Judge

December 21, 1999